

TEACHERS' RETIREMENT BOARD
EXECUTIVE COMPENSATION COMMITTEE

SUBJECT: Exempt Pay Structure

ITEM NUMBER: 4

ATTACHMENT(S): 1

ACTION:

DATE OF MEETING: October 10, 2001

INFORMATION: X

PRESENTER: Peggy Plett/Chris Waddell

PART A:

At the September meeting, the Committee acted to increase the base pay range for the CEO position from \$120,000-\$140,000 to \$135,000-\$160,000. No change was made to the existing pay incentive percentage (20%). Staff was then directed to follow past practice and submit this as a request to the Department of Personnel Administration to issue a pay letter authorizing the base pay range change.

Staff prepared the letter dated September 13, 2001 requesting DPA to make the change. Attachments to that request included a copy of the Watson Wyatt report prepared for CalPERS, a public retirement system salary comparison report recently completed by the Missouri State Employees' System (MOSERS), and current base pay for three recently hired CEOs in other states. Each of these comparative reports reflected that the CalSTRS base salary for the CEO position was substantially below that of comparable and significantly smaller systems.

To date, the Department of Personnel Administration has not responded to staff's request. Ms. Plett will provide an update at the meeting.

PART B

Developments in CalPERS Litigation

On September 13, 2001, CEO Jim Mosman signed a declaration that was filed by CalPERS in the litigation with State Controller Kathleen Connell (*Connell v. CalPERS et.al.*, Sacramento Superior Court Case No. 01AS00633). This declaration, which outlines some of the history and concerns regarding compensation of exempt CalSTRS staff, is attached for the Committee's reference. It was filed in conjunction with CalPERS' response to the Controller's motion for a preliminary injunction, which is scheduled for hearing on October 1, 2001. For the Committee's reference, the following is a brief summary of that litigation.

On April 18, 2000, following a salary survey and in consideration of recruitment and retention difficulties, the CalPERS Board decided to increase the base pay of its exempt Portfolio Managers (their fourth level of investment professionals) from the range of \$80,000 to \$95,000 to a new range of \$88,000 to \$105,000. CalPERS forwarded this matter to the Department of Personnel Administration for the issuance of a “Pay Letter” that would implement the new salary range. On October 17, 2000, DPA orally informed CalPERS that it declined to issue a pay letter, and CalPERS then directly transmitted the information in a letter to the Controller dated October 20, 2000. On October 26, 2000, the Controller’s Office stated in writing that it would not process these pay increases.

Thereafter, on November 15, 2000, CalPERS advised the Controller’s Office in writing that under its “plenary and exclusive fiduciary responsibility over CalPERS assets, the investment of those assets, and the administration of CalPERS” pursuant to Article 16, Section 17 of the Constitution (Proposition 162), it had developed its own payroll system. CalPERS further stated that beginning with the November 2000 pay period, it would assume full responsibility for paying its exempt Portfolio Managers and for ensuring continuity of mandatory and voluntary benefits and deductions (e.g., retirement, health, dental, vision) and for reporting income to the Internal Revenue Service. Although CalPERS instructed the Controller’s Office to remove these employees from the Centralized Payroll System, the Controller’s Office declined. Consequently, the state payroll system continues to generate duplicate paychecks for these employees, which CalPERS must handle in a manner that avoids tax and benefits complications for the affected employees.

On January 31, 2001, the Controller, in her official capacity, filed a complaint for declaratory and injunctive relief that initiated the above-captioned litigation. The complaint challenged the actions of CalPERS with respect to the compensation of the Portfolio Managers as well as other CalPERS actions pertaining to Board member meeting stipends, reimbursement to public agencies for release time for Board members to attend meetings, and per diem travel reimbursement.

Both CalPERS and the Controller are represented by outside counsel in this litigation. Following early rounds of the litigation that narrowed the scope of the Controller’s complaint, the Controller on August 20, 2001, filed motions for a judgment on the pleadings and for a preliminary injunction. A hearing will be held on these motions on October 1, 2001. Staff will provide an oral update on the outcomes of these motions, if known, and any other developments at the meeting.

Implications for CalSTRS

The CalPERS litigation squarely raises the ultimate issue of whether Proposition 162 provides to California public pension boards such as CalSTRS the authority to make independent compensation decisions notwithstanding State control agency limitations. Ultimately, but not immediately, the litigation will have significant ramifications for CalSTRS. As was discussed at the September meeting of the Committee, the issue of compensation of exempt CalSTRS staff involves three overlapping types of issues: **1) Human Resources** (What is the appropriate salary level for these professionals?); **2) Political** (Will DPA and/or the Controller process the salary levels ultimately determined to be appropriate by the Committee and the CalSTRS Board?) and **3) Legal** (If DPA and/or the Controller will not process the salary levels determined to be appropriate by CalSTRS, what if any legal recourse does CalSTRS have if the Board wishes to pursue the matter?). Essentially, we are at Step 1 with respect to compensation of exempt employees other than the CEO and at Step 2 for the CEO salary issue.

The above summary of the circumstances leading to the CalPERS litigation is provided as an illustration of one of three potential options available to CalSTRS if and when CalSTRS gets to Step 3. The second option would be to wait for partial or full resolution of the CalPERS litigation and supporting CalPERS in that litigation. The final option would be a direct lawsuit against DPA and possibly the Controller following a failure to implement pay levels determined to be appropriate by the Board. Staff will not provide any analysis, opinion, or recommendation concerning any of these options at the October meeting. It is premature to do so, and any such discussions would have to take place in a closed session of either the Committee or the Board as a whole. It should be noted that any such closed session would likely require the exclusion of one or more Board members owing to their official capacity and the potential for conflicts of interest.

Staff is sharing the above information with the Committee at this point in time for two reasons. First, to answer questions which have arisen in recent months about the CalPERS litigation and the possible implications for CalSTRS. Second, to emphasize that any salary setting process engaged in by CalSTRS will be subject to scrutiny by both state agencies and potentially the courts. For this reason, and in light of the Board's fiduciary responsibilities, CalSTRS will be well served if it continues to develop a full and complete record upon which to justify its salary determinations.

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RETIREMENT SYSTEM BOARD OF
ADMINISTRATION, JAMES E. BURTON,
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WILLIAM B. ROSENBERG

SUPERIOR COURT OF THE STATE OF CALIFORNIA
FOR THE COUNTY OF SACRAMENTO

KATHLEEN CONNELL, in her official
capacity as Controller of the State of
California,

Plaintiff,

v.

CALIFORNIA PUBLIC EMPLOYEES'
RETIREMENT SYSTEM BOARD OF
ADMINISTRATION, JAMES E. BURTON,
ROBERT F. CARLSON, MIKE
QUEVEDO, JR., WILLIAM B.
ROSENBERG, and DOES 1-25, inclusive,

Defendants.

CASE NO. 01AS00633

**DECLARATION OF JAMES D. MOSMAN
IN RESPONSE TO PLAINTIFF'S
MOTION FOR PRELIMINARY
INJUNCTION**

Date: October 1, 2001
Time: 2:00 p.m.
Dept: 53

(Honorable Charles C. Kobayashi)

Complaint Filed: January 31, 2001

1 I, James D. Mosman, declare as follows:

2 1. I am the Chief Executive Officer ("CEO") of the California State Teachers'
3 Retirement System ("CalSTRS"). I was appointed to this position by the Teachers' Retirement
4 Board ("Board") in November 1988. By law, I am the chief administrative officer of CalSTRS,
5 and have the responsibility for administration of the CalSTRS system pursuant to policies and
6 rules adopted by the Board. In addition, I act as secretary to the Board and am in charge of all
7 board correspondence and the keeping of a record of board proceedings. I have personal
8 knowledge of the matters set forth in this declaration and am competent to testify thereto if called
9 as a witness. I make this declaration in connection with the litigation styled *Connell v. CalPERS*,
10 *et al.*, Case No. 01AS00633, in support of CalPERS' opposition to the Controller's motion for
11 preliminary injunction.

12 2. Prior to my appointment to the CEO position, I served as the Director of the
13 Department of Personnel Administration ("DPA") from January 1985 through October 1988, and
14 as Deputy Director of DPA from January 1983 through December 1984. DPA manages most of
15 the personnel and human resource functions of the State.

16 3. The Board has established an Executive Compensation Committee ("Committee")
17 and charged it with the authority and responsibility to:

- 18 • Determine the appropriate compensation level for the CEO, Chief
19 Investment Officer ("CIO") and other CalSTRS employees exempt from the civil service system;
- 20 • Develop performance criteria and manage a pay incentive program for
21 exempt positions and the Executive Staff of CalSTRS;
- 22 • Annually assess performance and recommend to the Board the extent to
23 which performance pay should be awarded.

24 The Committee meets at least annually to assess performance and adjust compensation.

25 4. CalSTRS commissioned a study on the development of incentive pay programs for
26 all exempt positions that was presented to the Committee at its June 1999 meeting. The study
27 included a comparison of the compensation for CalSTRS and CalPERS exempt positions,
28 including base pay and, where applicable, incentive compensation.

1 5. At the Committee's direction, following the June 1999 meeting, CalSTRS staff
2 began work with DPA to increase the base pay levels and to establish incentive pay programs for
3 all exempt positions. In July 1999, DPA indicated its opposition to incentive pay. In August
4 1999, CalSTRS dropped the incentive pay components and informally proposed a salary structure
5 to DPA. DPA responded that it wished to conduct a salary study for the positions.

6 6. In April 2000, DPA notified CalSTRS by phone that its "final position" was a ten
7 percent range adjustment for the Investment Directors, but no adjustments for any other exempt
8 positions. This position was subsequently documented by letter in May, and a pay letter
9 authorizing the increase was issued in June 2000 with an effective date of January 1, 2000. DPA
10 did not share information with CalSTRS regarding a salary study, and I have no indication that
11 such a study was ever performed.

12 7. Since 1997, the Board has conducted three searches for exempt investment staff. I
13 am familiar with each of these searches. In 1997, a search was conducted for the position of
14 Director of Alternative Investments. In 2000, searches were conducted for the Director of Real
15 Estate and Chief Investment Officer ("CIO") positions. In each instance, the pool of qualified
16 candidates was very small. Executive search firms were used in each of these searches, and we
17 were advised that the compensation level for each position was the major contributor to the small
18 applicant pools.

19 8. I am leaving CalSTRS at the end of 2001 to become the Executive Director of the
20 National Council on Teacher Retirement, and the Board is currently conducting a search for my
21 replacement. At the September 5, 2001 meeting of the Executive Compensation Committee,
22 several Committee members who had previously attended a meeting of the search committee
23 were present. They stated that the consultant conducting the search had advised them that the
24 current salary for the position was lower than that paid by several smaller pension systems. They
25 further stated that the consultant said that the salary level would preclude a number of otherwise
26 qualified candidates from applying.

27 9. The Committee also had before it salary data from a survey conducted for
28 CalPERS by Watson Wyatt, a consultant. Based upon the information before it and the

1 Committee's concern that the Board be able to choose a CEO from a highly qualified pool of
2 applicants, the Committee adopted a motion to increase the salary of the CEO position from the
3 current range of \$120,000 to \$140,000 to a new range of \$135,000 to \$160,000. The Committee
4 further directed staff to take the necessary steps to effect the new salary, including submission to
5 DPA for approval.

6 10. In addition, the Committee voiced its concern about the adequacy of the entire
7 exempt pay structure at CalSTRS, including both investment and non-investment positions, and
8 directed staff to bring alternatives for hiring of a consultant to complete a salary survey for all
9 exempt positions to the Committee for consideration at its next meeting in October 2001.

10 I declare under penalty of perjury under the laws of the State of California that the
11 foregoing is true and correct to the best of my knowledge and belief. This declaration was
12 executed on September ___, 2001 at Sacramento, California.

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15 James D. Mosman
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